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May 5, 1999

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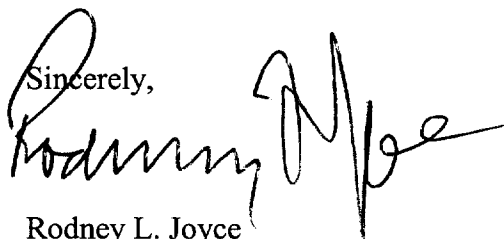
Ms. Magalie Roman Salas, Secretary
Federal Communications Commission
445 12th Street, S.W., Fifth Floor
Washington, D.C. 20554

Re: CC Dkt. No. 98-147 Ex Parte Filing

Dear Ms. Salas:

On behalf of Network Access Solutions Corp., I submit three copies of a 13-page white paper on an important issue that has been the subject of several ex parte presentations within the past few weeks. That issue concerns the question of whether Section 251(c)(4) of the Communications Act requires an ILEC to sell to CLECs, at a wholesale price, a volume discounted DSL service plan that the ILEC markets to ISPs. The enclosed paper concludes that the statute imposes this obligation, and it refutes each of the arguments that ILECs have made in an effort to persuade the Commission otherwise.

Sincerely,



Rodney L. Joyce

Enclosure

cc: Staci Pies (with encl.) (by hand)

**A WHITE PAPER:
COMPETITION IN THE RESIDENTIAL DSL MARKET
WILL BE JEOPARDIZED UNLESS THE FCC REQUIRES
INCUMBENT LECS TO PROVIDE DSL
VOLUME DISCOUNT PLANS TO CARRIERS AT
A WHOLESALE PRICE**

by

Network Access Solutions Corp.

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Bell Atlantic has argued in a recent *ex parte* filing that the wholesale discount provision of the 1996 Act, Section 251(c)(4)(A), should not apply to the volume discount DSL service that the company apparently intends to provide to AOL and perhaps other Internet service providers ("ISPs").¹ We show in this White Paper that Bell Atlantic is wrong on both law and policy grounds.

Although we discuss below both the legal and policy issues in detail, we want to highlight the policy issues now. Doing so will help place this controversy in its proper context.

Bell Atlantic claims that its motive for seeking an exemption from Section 251(c)(4)(A) is noble. The company asserts that the discounted DSL offering it plans for ISPs is designed to ensure that ISPs get DSL service at the price that a fully competitive DSL market would ensure.

In fact, rather than seeking an exemption from Section 251(c)(4)(A) in order to give ISPs a good financial deal, Bell Atlantic actually seeks the exemption in order to preempt competition in the residential DSL market by capturing substantially all of that market for itself

¹ See attachment to letter from Suzanne Guyer to Magalie Roman Salas filed in CC Dkt. No. 98-147 ("Bell Atlantic White Paper").

before competitors ("CLECs") have an opportunity to compete on a facilities basis. We show in Part II below that CLECs cannot realistically hope to provide substantial facilities-based competition to incumbent LECs ("ILECs") in the residential DSL market until after the FCC adopts two rules that it has proposed but has not yet put in place. Until those two rules become effective, the only way for CLECs to compete with ILECs in this market is for the FCC to require that ILECs sell their volume discounted DSL offerings to carriers at a wholesale price as Section 251(c)(4)(A) contemplates. Exempting ILECs from this obligation now while adopting these two new rules several months later is no solution. By then, ILECs will have captured substantially all of the residential DSL market through their volume discount plans, making it needlessly difficult for CLECs to recapture any meaningful portion of that market once the Commission makes facilities-based competition possible.

BACKGROUND

On September 24, 1998, Bell Atlantic filed a transmittal revising its Tariff FCC No. 1 to add its first xDSL offering.² That offering, which Bell Atlantic calls Infospeed, uses ADSL technology to give consumers a high speed connection to the Internet.³

The Infospeed transmittal provides a prospective user of Infospeed service with three alternative transmission speeds. For \$39.95 per month, Bell Atlantic will provide a transmission speed of 640 kbs downstream and 90 kbs upstream. For \$59.95 per month, it will provide a

² Bell Atlantic Transm. No. 1081.

³ Although the tariff states that Bell Atlantic permits the service to be used solely to connect a computer terminal to an ISP (§ 16.8(c)(C)), Bell Atlantic's marketing materials state that it also sells the service as a way to connect computer terminals to a corporate LAN. *See, e.g.*, www.bell-atl.com/infospeed/more_info/whatis.html (visited May 3, 1999).

transmission speed of 1.6 mbs downstream and 90 kbs upstream. For \$109.95, the company will provide a transmission speed of 7.1 mbs downstream and 680 kbs upstream.

In response to Bell Atlantic's Infospeed transmittal, NAS and other CLECs filed petitions requesting that the FCC reject or suspend the transmittal on grounds that the prices proposed in the transmittal fail to recover Bell Atlantic's costs to provide Infospeed service. NAS noted, for example, that Bell Atlantic had admitted in the workpapers which accompanied the transmittal that Infospeed prices were insufficient to recover *any* loop costs and *any* central office space rental costs for DSLAM equipment even though those costs are the two most significant costs that a CLEC must incur in order to provide DSL service on a facilities basis.⁴

In an order released a few days later, the Commission deferred its investigation of allegations that Infospeed is predatorily priced until after it determined whether the FCC has jurisdiction to regulate the terms on which Infospeed is provided.⁵ Understandably, the agency felt it would be an inefficient use of resources to investigate allegations that Infospeed is predatorily priced until after it first confirms that it has jurisdiction to take action to terminate any such predation.

Three months later, the FCC completed its initial investigation, concluding (properly) that it has jurisdiction to regulate the terms under which Infospeed is provided.⁶ Unfortunately,

⁴ NAS's Pet. to Reject or Suspend at 1-4.

⁵ *Order Suspending Tariff and Designating Issues for Investigation*, DA 98-1863 (rel. Sept. 15, 1998).

⁶ *Bell Atl. Tel. Cos.*, FCC 98-317 (rel. Nov. 30, 1998).

however, the FCC still has not instituted an investigation into the question of whether the prices that Bell Atlantic charges for Infospeed are predatory.

Although Bell Atlantic has not yet disclosed the terms of its planned volume discount DSL offering to ISPs, press reports suggest that the company may be planning to provide DSL service to ISPs at about half the price of the comparable service it provides under the Infospeed brand.⁷ Presumably, Bell Atlantic will file a tariff transmittal which sets forth the terms of its new lower price offering as a volume discount plan.

I. The Communications Act Requires that an Incumbent LEC Sell to Carriers at a Wholesale Price Any DSL Volume Discount Plan that the LEC Markets to Internet Service Providers

By its express terms, Section 251(c)(4)(A) requires that an ILEC sell to CLECs at a wholesale price *any* telecommunications service that meets each of two conditions. First, the service must be one that is provided to “customers who are not telecommunications carriers.” Second, it must be a service that the ILEC provides “at retail.”

While Bell Atlantic asserts that its proposed DSL volume discount plan meets *neither* statutory precondition to the application of Section 251(c)(4)(A), the Commission already has held that it meets *both*. Bell Atlantic’s claim that by marketing the plan to ISPs, Bell Atlantic is offering the service to “telecommunications carriers” is absurd.⁸ The FCC has held repeatedly that ISPs are *not* telecommunications carriers since the Internet access service they provide is not

⁷ See, e.g., “SBC, Bell Atlantic Push Expanded ADSL Rollouts,” *Telecommunications Reports*, January 18, 1999, at 21-22 (ADSL upgrade expected to cost AOL subscribers less than \$20 per month).

⁸ Bell Atl. White Paper at 1, 3 (referring to ISPs as carriers).

“telecommunications service.”⁹ The FCC likewise has rejected the claim that DSL service is not provided “at retail” merely because it is marketed to ISPs.¹⁰

The FCC’s finding that DSL service is a retail offering if marketed to ISPs is consistent with the plain wording of Section 251(c)(4)(A). By its terms, that section categorizes a service provided to a carrier as a retail offering, but it exempts that category of retail offering from the obligation created by that section for reasons that will be discussed below. If a service provided to a carrier is a retail offering, there would be no rational basis upon which the FCC could read the statute as giving the agency authority to hold that a service marketed to ISPs is a non-retail offering.

Although Bell Atlantic offers several arguments designed to persuade the FCC to reverse (or ignore) its holding that a service marketed to an ISP is provided “at retail,” none has merit. Accepting Bell Atlantic’s first suggestion -- that the FCC classify a service as “retail” *only* when sold to customers who do not use the service as an input into the cost of the products that the customers market to consumers¹¹ -- would be ill-advised since it would open a gaping loophole in Section 251(c)(4)(A). With this policy in place, *all* telecommunications services marketed to businesses would be exempt from the requirement set forth in Section 251(c)(4)(A) since *all* are an input into the products sold by the businesses who subscribe to them. For example, not only would

⁹ Federal-State Joint Board on Universal Service, *Report and Order*, 12 FCC Rcd 8776, 9180 (1997), *Report to Congress*, 13 FCC Rcd 11501, 11536 (1998); *see also* Implem. of Section 703(e) of the Telecom. Act of 1996, *Report and Order*, 13 FCC Rcd 6777, 6795 (1998) (Internet over cable is a non-telecommunications service); GTE Tel. Oper. Cos., *Memorandum Opinion and Order*, 13 FCC Rcd 22466, 22477-78 (Internet over DSL is a non-telecommunications service).

¹⁰ Deployment of Wireline Services Offering Advanced Services, *Notice of Prop. Rulemaking*, 13 FCC Rcd. 24011, 24094-95 (1998).

¹¹ Bell Atl. White Paper at 2-3.

ILECs be exempt from the obligation to sell a DSL volume discount plan like the one at issue here to CLECs at a wholesale price, they also would be exempt from the duty to sell T-1 and DS-3 services to CLECs at wholesale since those services also are used by ISPs (and the other businesses to which such services are sold) as an input to products that the ISPs (and other business subscribers) sell. Similarly, ILECs no longer would be required to provide CLECs with a wholesale price for the specialized telecommunications services that ILECs provide to private pay telephone owners since pay phone owners use those services as an input to their payphone offerings.¹² Business exchange service also no longer would be subject to Section 251(d)(4)(A) since business exchange service is an input into the products sold by the businesses who subscribe to that service.

Nor is there a basis to accept Bell Atlantic's suggestion that the FCC declare a volume discount DSL plan to be a non-retail offering on the theory that ILECs would enjoy no cost savings if they were to provide the plan to CLECs instead of ISPs.¹³ In fact, ILECs *do* enjoy cost savings when they provide a DSL volume discount plan to CLECs rather than ISPs. For example, when selling the plan to CLECs, an ILEC would bear *none* of the expenses it incurred to develop a plan that meets the needs of ISPs and *none* of the expenses it incurred to market that plan. However, even if ILECs could prove that they enjoy no cost savings by offering volume discount DSL plans to CLECs rather than to ISPs (which they cannot do), this fact would be irrelevant since the FCC has held that CLECs are entitled to the same discount for all retail telecommunications services

¹² Not surprisingly, the FCC already has rejected the claim that payphone owners fail to obtain telecommunications services from ILECs "at retail" merely because they use those services as an input into the pay telephone services they sell. *Implem. of the Local Comp. Provisions of the Telecom. Act of 1996, First Report and Order*, 11 FCC Rcd. 15499, 15936 (1996).

¹³ Bell Atl. White Paper at 2.

purchased from ILECs even though different cost savings may be attributable to different types of service.¹⁴

The fact that Bell Atlantic's DSL volume discount plan will be a discounted version of Bell Atlantic's already tariffed DSL offering also has no bearing on whether the volume discount plan is a retail offering, notwithstanding Bell Atlantic's contrary claim.¹⁵ Nearly three years ago, the Commission concluded that "no basis exists for creating a general exemption from the wholesale requirement for discounted service offerings made by incumbent LECs. A contrary result would permit incumbent LECs to avoid the statutory resale obligation by shifting their customers to nonstandard offerings, thereby eviscerating . . . [Section 251(c)(4)(A)]"¹⁶ Indeed, the Commission has ruled that a service is a retail offering even if the ILEC provides the service as a loss leader.¹⁷

There also is no merit in Bell Atlantic's assertion that ISPs not affiliated with CLECs will be forced to pay more for volume discounted DSL service than their carrier-affiliated competitors if the Commission reaffirms that ILECs' DSL discount plan offerings' to ISPs are retail services.¹⁸ No CLEC who purchases Bell Atlantic's volume DSL plan be able lawfully to resell that

¹⁴ 11 FCC Rcd. at 15956 (the amount of the wholesale discount available to CLECs shall be equal to the costs that the ILEC "would no longer incur if it were to cease retail operations and instead provide all of its services through resellers").

¹⁵ Bell Atl. White Paper at 3 ("these types of bulk offerings -- which are already deeply discounted -- cannot lawfully be subjected to a further wholesale discount").

¹⁶ Implem. of the Local Comp. Provisions of the Telecom. Act of 1996, *First Report and Order*, *supra*, 11 FCC Rcd. at 15970.

¹⁷ *Id.*, 11 FCC Rcd. at 15973.

¹⁸ Bell Atl. White Paper at 4.

plan at a lower price to an affiliated ISP than to non-affiliated ISPs given the requirement in Section 202(b) that all carriers sell telecommunications service to all customers on non-discriminatory terms.

Finally, the fact that Section 251(c)(4)(A) exempts ILECs from the duty to provide CLECs with a wholesale price for a service they initially market to another CLEC does not justify a similar exemption when the service is marketed initially to an ISP as Bell Atlantic suggests.¹⁹ Section 251(c)(4)(A) exempts ILECs from the duty to provide other CLECs with a wholesale price for a service they provide initially to another CLEC in order to ensure that all CLECs can obtain the same service on nondiscriminatory terms as Section 202(a) of the Act requires. Without this exemption, the first CLEC subscribing to a particular ILEC-provided service would be discriminated against *vis-a-vis* all subsequent subscribers since the first subscriber would pay the retail price and all subsequent subscribers would pay the wholesale price for the same service. This problem of discrimination does not exist when, as occurs in the volume discount DSL plan at issue here, the first subscriber is an ISP and subsequent subscribers are CLECs desiring to resell that service to other ISPs.

II. Competition in the Residential DSL Market is Unlikely to Develop Unless the FCC Both Enforces Section 251(c)(4)(A) and Adopts Two Rules that it Has Proposed

Even if it were not clear that Section 251(c)(4)(A) required ILECs to provide DSL volume discount plans to CLECs with a wholesale price, the Commission should resolve the ambiguity by requiring ILECs to do so since this may be the only way to ensure that competition in the residential DSL market has an opportunity to develop. Bell Atlantic's threat to increase the price it charges ISPs under its volume discount DSL plan if the FCC fails to exempt it from the

¹⁹ *Id.* at 2.

requirement to sell these plans to carriers at wholesale is strong evidence that the residential DSL market is not now competitive since only a monopolist could carry out this threat.²⁰ In a competitive market, Bell Atlantic would have no power to raise DSL prices or restrict DSL output since its customers then would turn to its competitors for DSL service, and Bell Atlantic would face a disastrous loss of market share.

While the residential DSL market is not yet competitive, there are a number of CLECs, including NAS, who are poised to provide service to ISPs at competitive rates on a facilities basis once the agency adopts two important market opening measures that it has proposed and that are discussed below. In the meantime, however, the Commission must enforce Section 251(c)(4)(A) or else ILECs will be able to preempt facilities-based competition in the residential DSL market before it has an opportunity to develop.

A. The Commission Should Require that an ILEC Permit CLECs to Provide Service Over the Same Loops that the ILEC Uses to Provide Exchange Service

The first rule that the Commission should adopt in order to promote facilities-based competition in the residential DSL market is one requiring that ILECs permit CLECs to provide DSL service on the high-frequency band of a given local loop while the ILEC provides exchange service over the low-frequency band of that loop. The Commission already has found that there is no technical barrier to such line sharing and has tentatively concluded that it should require such sharing.²¹ It stopped short of mandating line sharing only because of vague “operational” issues

²⁰ Market power -- the power that is held by a monopolist -- is defined as the ability to raise prices and restrict output without losing profitability. *See Eastman Kodak Co. v. Image Technical Services*, 504 U.S. 451, 464 (1992).

²¹ Deployment of Wireline Services, *Further Notice of Prop. Rulemaking* at ¶ 96, FCC 99-48 (rel. (continued...))

raised by ILECs in a last-ditch effort to suppress this form of competition. Rather than seeking to define all operational issues prior to taking action, the Commission instead should give ILECs a deadline to develop solutions for all operational issues that exist. Proceeding in this fashion would be consistent with the way the Commission has dealt with operational issues that result from other aspects of the ILEC/CLEC business relationship. For example, although the FCC recognized that ILECs might face a variety of operational issues in providing CLECs with reasonable and non-discriminatory UNE pre-ordering, ordering provisioning, maintenance and repair service, it did not seek to define the operational issues before mandating that LECs provide CLECs with these back office services. Instead, the agency required that ILECs identify all operational problems, and it mandated that ILECs design systems and procedures to deal with them.²²

Mandating line sharing will facilitate facilities-based competition in the residential DSL market because it will place Bell Atlantic and its competitors on an equal footing with respect to the loop cost component of DSL service. As discussed above, Bell Atlantic's initial DSL tariff transmittal failed to attribute any recurring loop costs to the company's DSL revenue requirement, even though the FCC has held that recurring loop costs amount to approximately half the total cost of providing DSL service.²³ Bell Atlantic can afford to attribute no loop costs to DSL service by attributing all of its loop costs to the exchange service it provides over the same loop. Currently, Bell Atlantic's DSL competitors do not have that option since Bell Atlantic does not permit

²¹ (...continued)
March 31, 1999).

²² See Implem. of the Local Comp. Provisions of the Telecom. Act of 1996, *First Report and Order*, *supra*, 11 FCC Rcd. at 15767-68.

²³ *Id.* at ¶ 106 n.226.

competitors to share the loops that Bell Atlantic uses to provide exchange service. Instead, Bell Atlantic requires competitors who wish to provide DSL service to purchase separate loops as unbundled network elements. This is a direct cost that increases competitors' cost of providing DSL service.

If a CLEC could obtain loops necessary to provide DSL service at no incremental cost, as Bell Atlantic does, any threat that Bell Atlantic could credibly make to raise the price of a volume discount plan would be reduced since the CLEC might then be able to underprice the Bell Atlantic plan. For example, Covad announced last week that it now offers DSL service to ISPs serving residential customers at a monthly rate of \$39.²⁴ If about half of this \$39 price is attributable to loop costs, as the Commission's findings indicate, then Covad might be able to price this service at less than \$20 if it were able to use Bell Atlantic's pricing model. At this rate, if Bell Atlantic raised its price for DSL service it would rapidly find itself without customers.

B. The Commission Should Require an Incumbent LEC to Provide DSL Service Through a Separate Affiliate and to Treat that Affiliate the Same as it Treats All Other CLECs

Mandating line sharing alone may not be sufficient to prevent Bell Atlantic from preempting competition in the facilities-based residential DSL market, however, since Bell Atlantic's failure to attribute any collocation costs to its DSL offerings (as discussed above), while forcing CLECs to pay significant collocation costs, constitutes another substantial and unfair cost advantage over CLECs desiring to compete with Bell Atlantic in the residential DSL market. To address this inequity, the Commission should mandate that an ILEC provide DSL service through a separate

²⁴ See, e.g., http://www.covad.com/about/press_releases/press_042099.html (visited May 3, 1999) (lowest price for a speed of 384 kilobits per second).

entity and require that the ILEC treat its DSL affiliate the same way it treats all other DSL providers. This would require that the ILEC attribute to its DSL services the same collocation costs that it imposes on its DSL competitors. While the Commission has proposed to give an ILEC the *option* of providing DSL service through a separate affiliate that is barred from receiving more favorable collocation terms from its affiliated ILEC than other CLECs,²⁵ adopting this proposal would not level the uneven playing field that exists today since it is unlikely that most ILECs will *voluntarily* forego the tremendous cost advantages they currently have in providing DSL service. Only by *requiring* ILECs to treat their own DSL affiliates in the same way they treat competitors will the Commission ensure that *all* DSL providers account for the same collocation charges.

CONCLUSION

The Commission should make clear that Section 251(c)(4)(A) applies to any volume discount DSL service offerings that ILECs market to ISPs. Failing to take this action would have the unfortunate effect of permitting ILECs to foreclose competition in the residential DSL market before facilities-based competition in that market has a chance to emerge. In addition, the Commission should act immediately to promote facilities-based competition in the residential DSL market by adopting two market-opening measures that it has already proposed: it should mandate line-sharing between voice and DSL service providers, and it should require that an ILEC provide DSL service through a separate entity and treat that entity in the same way as it treats all other DSL providers. By acting immediately to open the residential DSL market to resale and facilities-based

²⁵ Deployment of Wireline Services Offering Advanced Services, *Notice of Prop. Rulemaking*, *supra*, 13 FCC Rcd. at 24050.

competition, the Commission will ensure that the ominous scenario Bell Atlantic describes -- higher prices for DSL service and slower deployment of high-speed services to the home -- never comes to pass.